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July 13, 1999

Ex Parte

Magalie Roman Salas
Secretary
Federal Communications Commission
445 - 12th Street, SW - TW-A325
Washington, D.C. 20554

EX PARTE OR LATE FILED

Re: CC Docket No. 96-262

Dear Ms. Roman Salas:

On July 13, 1999, the undersigned, along with Scott Randolph, (GTE), Pete Martin (BellSouth), John Bosley (Bell Atlantic), Tony Alessi (Ameritech), Whit Jordan (BellSouth) and John Kure (U S WEST), on behalf of the United States Telephone Association, met with Jay Atkinson, Aaron Goldschmidt and John Scott of the Common Carrier Bureau.

The purpose of the meeting was to discuss local switching rate structure issues. The attached material was presented and discussed.

Pursuant to Commission Rule 1.1206(b)(1), an original and one copy of this letter and attachment are being provided to you for inclusion in the public record for the above-referenced proceeding. Please contact me with any questions.

Sincerely,

A handwritten signature in cursive script that reads "Linda Kent".

Linda Kent
Associate General Counsel

attachment

cc: J. Atkinson
A. Goldschmidt
J. Scott

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Local Switching

Rate Structure and Access Reform

Outline by USTA PC-ART Subgroup

Local Switching AT&T Arguments

- AT&T argues that excessive local switching returns must be reduced
- AT&T ignores the big picture
 - » Local switching cannot be viewed in isolation since it is part of an overall price regulation plan
 - » Local switching return has been inflated by a reduction in % of switching investment allocated to the interstate jurisdiction

Local Switching

Part of a Bigger Regulation Plan

A Total Company Productivity Factor is applied to all interstate prices

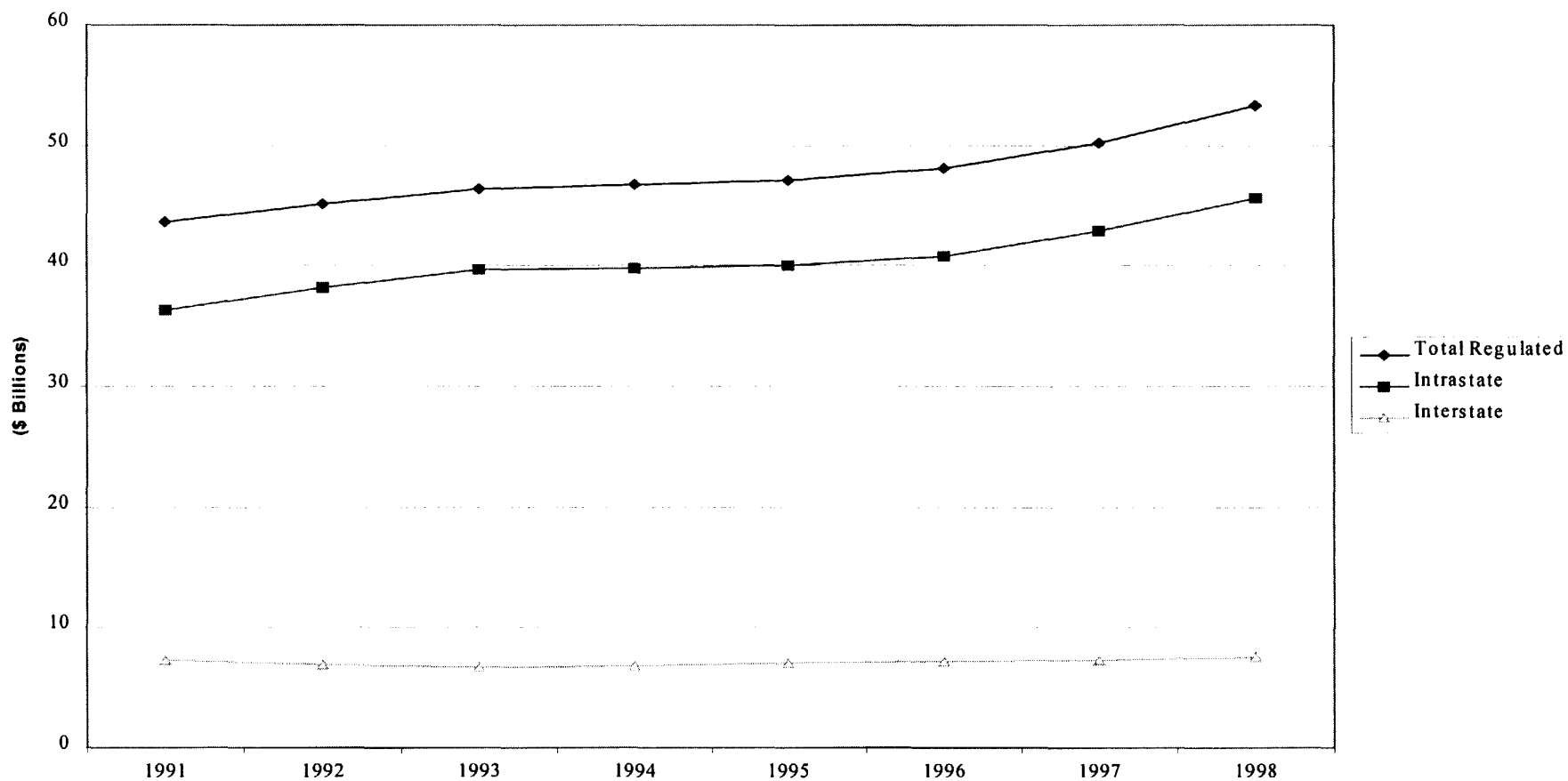
- » It is impossible to calculate separate X-factors for piece parts of the business

“The FCC reasonably concluded that “the record before us does not allow us to quantify the extent, if any, to which interstate productivity growth may differ significantly from total company productivity growth” [and] it is not clear that “interstate productivity,” as opposed to total company productivity, is measurable, or even economically well-defined. The Commission had previously recognized this analytical difficulty, questioning “whether it would be possible to develop separate production functions for interstate and intrastate services” (Price Cap Appeal Decision, 5/99)
- » Local Switching may have a relatively “high” return, but the returns for other price cap baskets are low or have a negative return
- » Looking at individual baskets in isolation ignores the overall working of price regulation. In effect, some universal service implicit support has been shifted into local switching from common line due to the working of a Total Company X-factor
- » Price regulation is working. Consumers have benefited. It is important that the efficiency maximizing incentive generated by price caps is **not** undermined.

Local Switching Observations

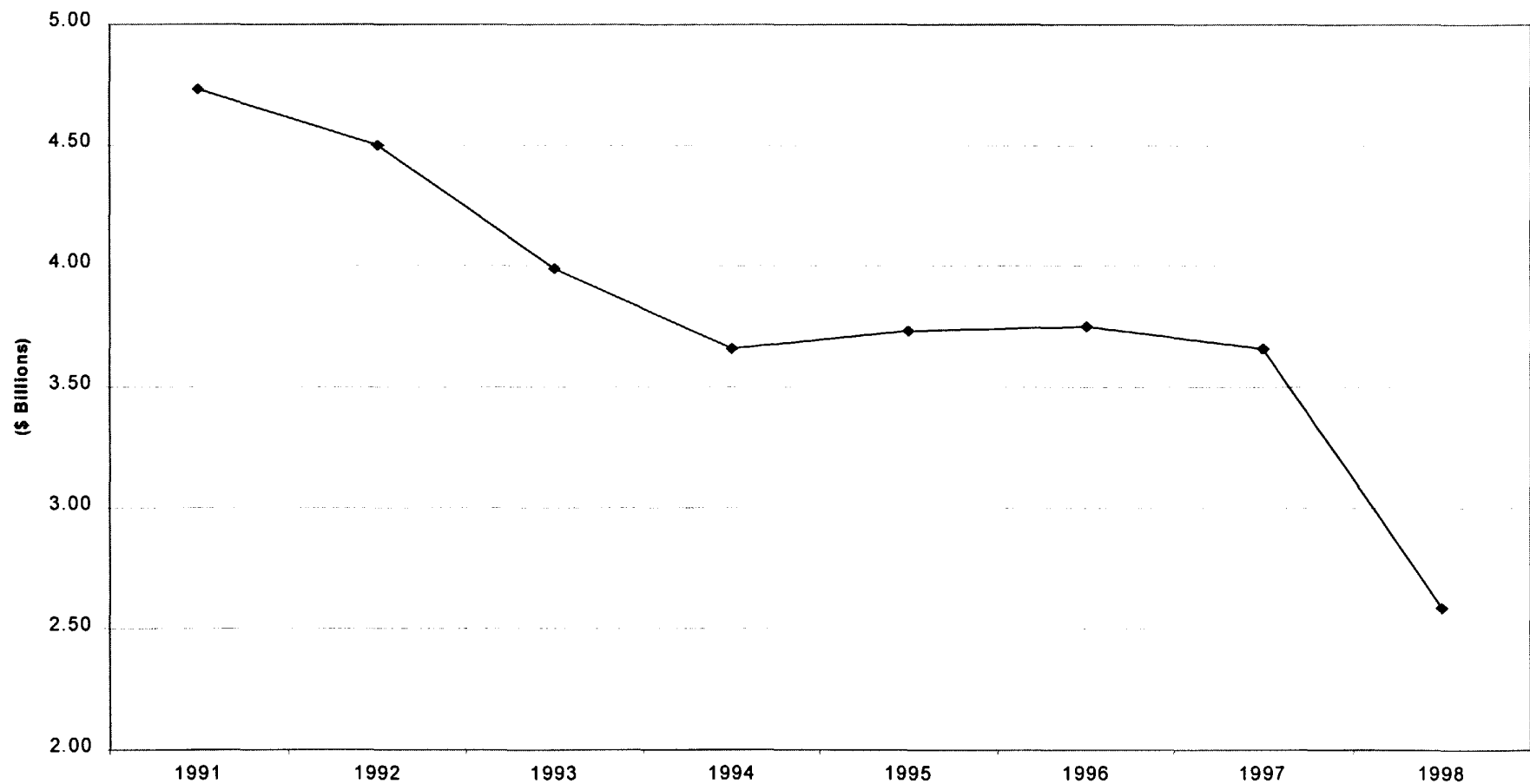
- It is **not** economically correct to look at local switching in isolation
- Observations
 - » Overall regulated switching investment has increased
 - » The % of switching investment/expense allocated to the interstate jurisdiction has declined significantly in recent years due in large part to internet usage
 - » Local switching expenses do not reflect a “declining cost industry”
 - » Industry growth rate for interstate switched access MOUs fell to <6% in 1998 from >7% in 1994

COE Local Switching Gross Investment



Interstate Local Switching

Average Net Investment

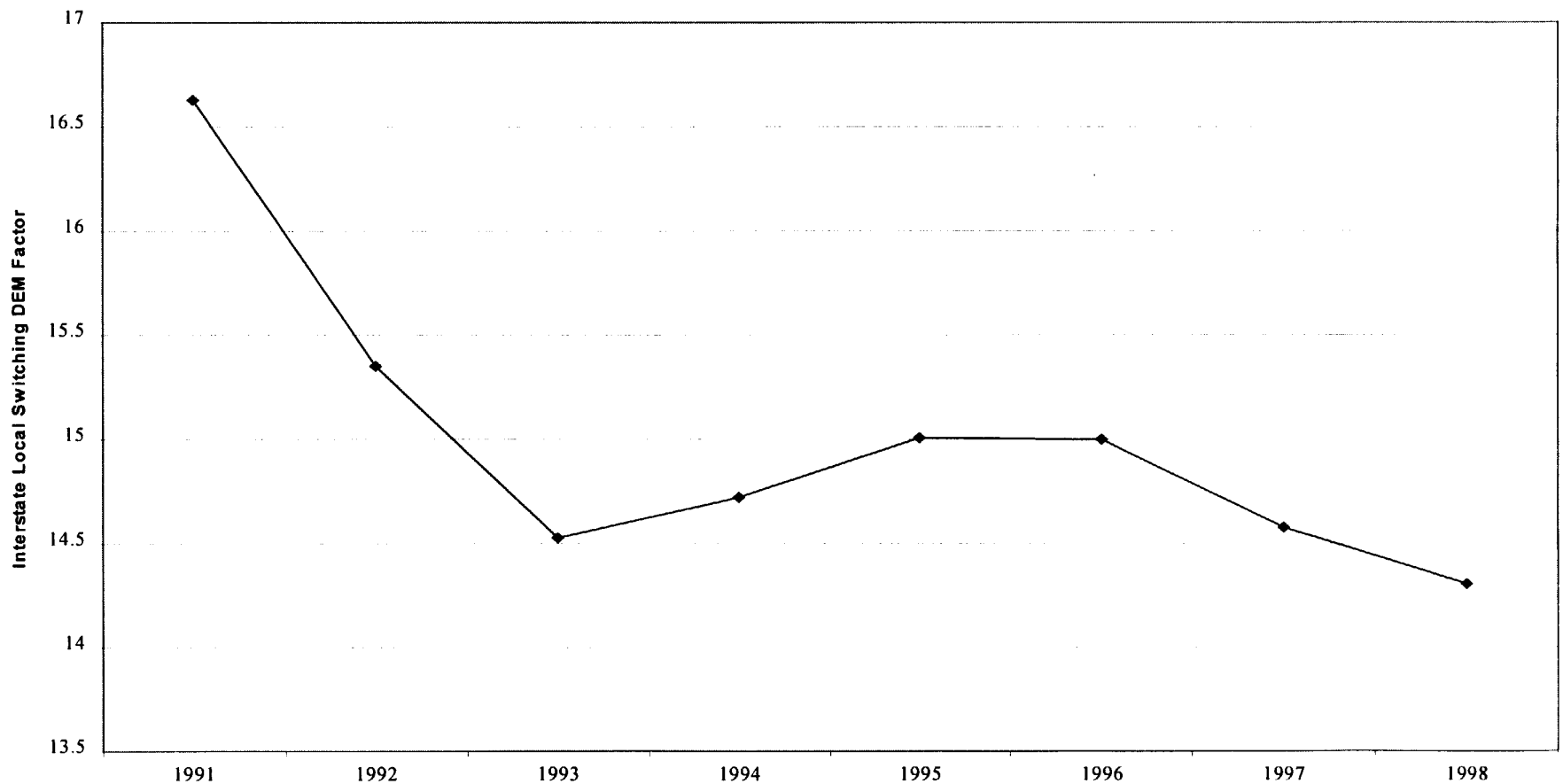


Interstate Local Switching

Gross and Average Net Investment

- Total regulated and Intrastate COE Local Switching Investment increased 22% and 25% between 1991 and 1998, while Interstate COE Local Switching Investment was flat over this same period
- $ROR = \text{revenues} - \text{expenses} / \text{Average Net Investment (ANI)}$
 - » From 1991 to 1993 LS ANI declined due to the DEM phase down
 - » In 1998 LS ANI further declined due to reassignment of line ports to the Common Line Basket
 - » LS ANI adjustments have contributed to the relatively “high” LS ROR

Interstate Local Switching DEM Factor



Interstate Local Switching DEM Factor

- The DEM Factor has declined due to:
 - » The transition from SPF to DEM
 - » The rapid growth of Internet usage

Local Switching Rate Structure

- Current Structure
 - » Local Switching per minute of use
 - » Flat Rated Trunk Port charges
 - » Flat rated charges for the line ports
 - » Permissive
 - Signaling, and
 - Call set up charges

Local Switching

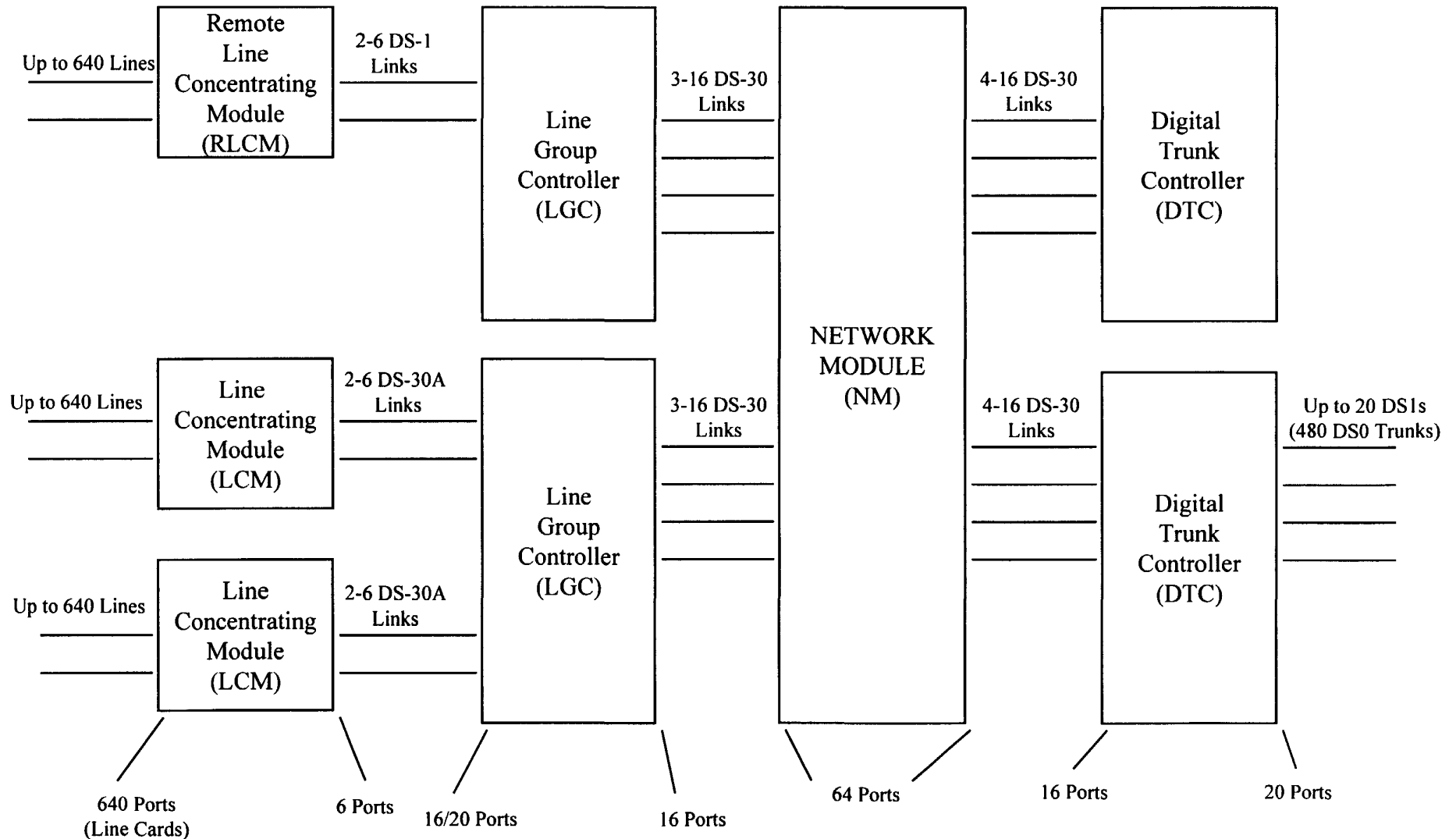
Alternative Rate Structures

- Alternative Proposed Structures

- » Sprint capacity based rate structure proposed for local interconnection in CC Docket No. 96-98
 - supposedly to address perception that switching investment is largely fixed
 - IXCs would buy links into switch per the Sprint proposal
- » Peak vs. Off-peak Pricing
 - Lower per minute of use rate in off-peak periods
 - reflects the perceived lower traffic sensitive costs during off-peak periods
- » Volume Discounts or Tapered charges

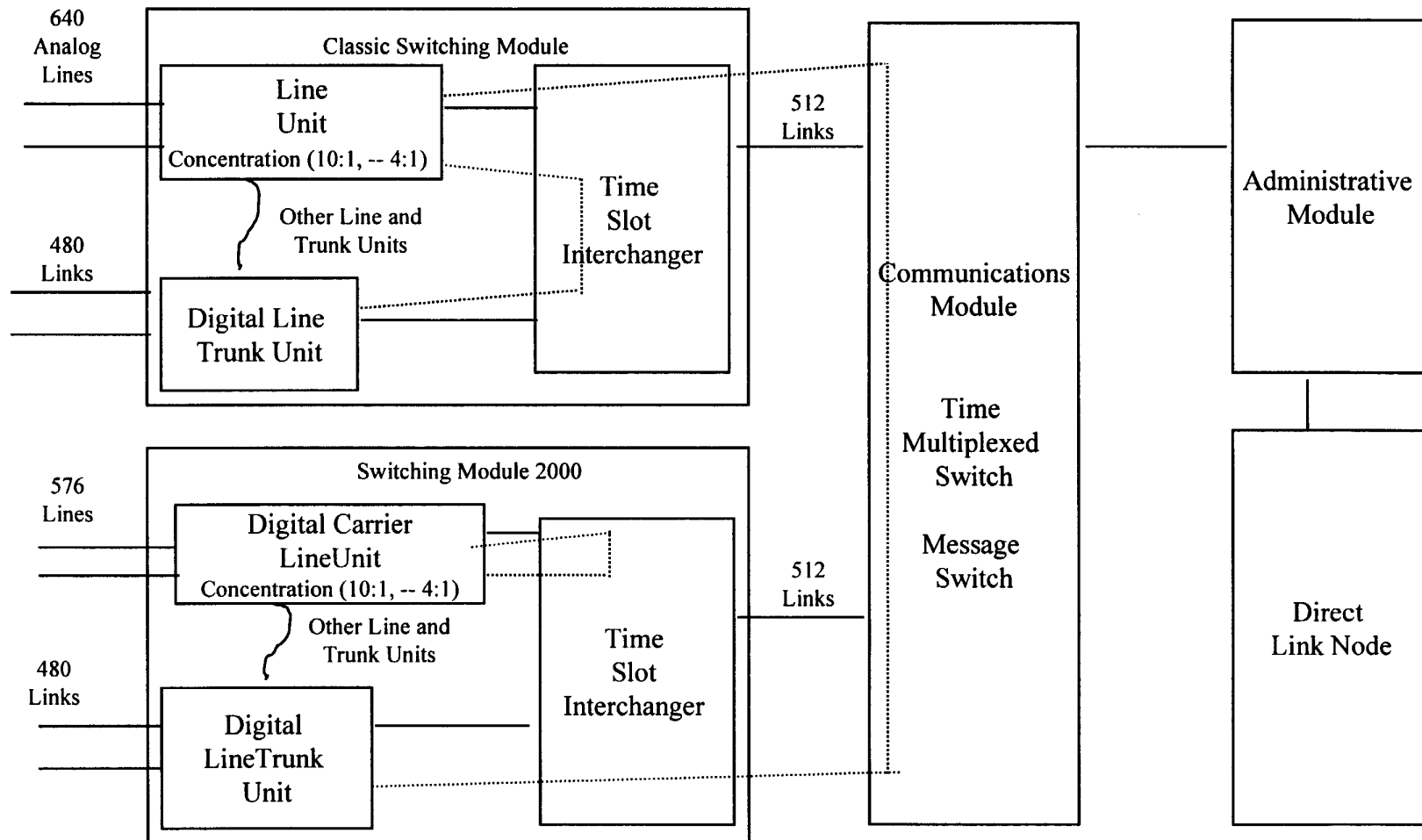
Simplified Diagram of a Switch

DMS-100



Simplified Diagram of a Switch

5ESS



Capacity Based Pricing

- Pros:

- » May provide economic incentives to IXCs to increase traffic in off-peak periods
- » May be beneficial to carriers that have a balanced pattern of traffic

- Cons:

- » May penalize small carriers that lack economies of scale
- » May be inefficient on the terminating side
 - Each carrier may have to purchase links to all terminating end offices
- » May be inefficient on the originating side
 - Each carrier may have to purchase sufficient capacity for its own busy hour
- » May result in loss of sharing efficiencies causing higher overall switching investment and higher rates to many consumers
- » May provide carriers an incentive to disconnect DTT to low volume switches
 - A mandated structure must not create an adverse incentive for IXCs to migrate DTT from end offices to tandems

Recommended Solutions for Local Switching Rate Structure

- Don't mandate new switching rate structures
 - » Let the marketplace determine optimal and efficient rate structures
- Allow ILECs to offer new switching rate structures without burdensome Part 69 waivers
 - » FCC may require that the existing rate structure is preserved
- Incentives may be offered to ILECs that provide capacity based rate alternatives